VZCZCXRO5521
OO RUEHCHI RUEHCN RUEHDT RUEHFK RUEHHM RUEHKSO RUEHNAG RUEHPB
DE RUEHML #2281/01 3042308
ZNR UUUUU ZZH
O 312308Z OCT 09
FM AMEMBASSY MANILA
TO RUEHC/SECSTATE WASHDC IMMEDIATE 5600
RUEATRS/DEPT OF TREASURY WASHDC IMMEDIATE
INFO RUEHZS/ASSOCIATION OF SOUTHEAST ASIAN NATIONS IMMEDIATE
RUEHZU/ASIAN PACIFIC ECONOMIC COOPERATION IMMEDIATE
RHHMUNA/USPACOM HONOLULU HI//FPA//

UNCLAS SECTION 01 OF 03 MANILA 002281

SENSITIVE

SIPDIS

STATE FOR EAP/MTS, EAP/EP/ EEB/IFD/OMA
STATE PASS EXIM, OPIC, AND USTR
STATE PASS USAID FOR AA/ANE, AA/EGAT, DAA/ANE
TREASURY FOR OASIA

E.O. 12958: N/A
TAGS: EFIN ECON ECIN RP CN XE XD
SUBJECT: Philippine Economic Update

REFS: A) Manila 1192, B) Manila 1351

SENSITIVE BUT UNCLASSIFIED

¶1. (SBU) Summary: The government's economic team reports that the Philippine economy continues to grow. The balance of payments is in surplus; international reserves are at a record high; foreign direct investment is increasing; the banking system remains sound; and the stock market is rebounding. The business sector, donor agencies, and other observers have expressed concern over longer-term constraints to growth and development. The past year's food, oil and global financial shocks, as well as natural disasters, have likely pushed more Filipinos into poverty. Shrinking fiscal resources will complicate efforts to boost growth and alleviate poverty, particularly for the new administration that assumes office after the May 2010 elections. End Summary.

Philippine Economy Holding Up

¶2. (U) On October 15, Cabinet secretaries from the government's economic team reviewed recent statistics, stressing that the country remains resilient and has reacted positively to signs of an emerging global recovery.
The Philippine's Gross Domestic Product (GDP) grew 1% in the first half of 2009, which is within the government's current 0.8%-1.8% target growth range for the full year.
Personal consumption and government spending spurred growth, making up for sluggish business investment. Consumer spending, the Philippine economy's main demand driver, grew at a faster rate during the second quarter than in the first, aided by improved consumer confidence, slowing inflation, and the continued resilience of overseas worker remittances. After an unimpressive first quarter, government spending accelerated markedly, with combined second-quarter government consumption and capital spending expanding 26% in real terms over last year's levels.

¶3. (U) The service sector, which accounts for more than half of Philippine economic output, accelerated to 3% growth in the second quarter, spurred by improved performances in private services, notably business process outsourcing (BPO), finance, real estate, and government services. Industrial output, down 2.5% year-on-year during the first quarter, declined by a smaller 0.3% in the second quarter as improved growth for the mining/quarrying, construction, and public utilities sub-sectors partially offset continued contraction (7%) in manufacturing output.

Remittances Continue to Grow

¶4. (U) Overseas remittances have slowed from the double-digit growth rates of past years but have held up better than expected, supporting economic growth and the balance of payments. January-August remittances of $11.3 billion increased 4% over 2008's comparable period. Though modest in U.S. dollar terms, when converted to pesos, it translates to 16% growth because of a fall in the exchange rate, and, subtracting out inflation, to 12% growth in real peso terms over 2008.

¶5. (U) Cumulative January-August 2009 merchandise exports were off 30% from 2008's level, and electronics exports (which contribute 60% of annual export revenues) down by 32%. However, the merchandise export drop has been slowing since April, with August's total exports down 21% year-on-year, the slowest decline posted since December 2008. Officials of the Semiconductor and Electronics Industry Association of the Philippines (SEIPI) said they expect modest growth in their industry's exports during the fourth quarter due to improved demand and depleting global stocks.

¶6. (U) The Philippines merchandise import bill also contracted (31% as of August) which, combined with higher overseas worker remittances and income from the growing BPO sector, has kept pressure off the current account. A smaller oil import bill (a combination of lower imported volumes and international prices) was a significant factor, as were lower imports of raw material for the electronics manufacturing industry.

Investment Flowed out Last Year, Flowing in in 2009
-- ------

¶7. (U) Foreign direct investments began improving during the second

quarter, pulling up cumulative January-July 2009 net inflows to $1.2 billion, up nearly 34% from January-July 2008. Central Bank-registered foreign portfolio capital (required for investors who seek to purchase foreign exchange from the banking system to remit profits) mustered $230 million in net inflows during the first nine months of 2009 - a significant turnaround from the $855 million in net foreign portfolio capital withdrawals posted during the first nine months of 2008.

¶8. (U) The balance of payments remains in surplus ($2.8 billion from January-August, exceeding the government's $1 billion full-year forecast). The Central Bank's gross international reserves have risen to a record-high $42 billion as of September -- equivalent to eight months of merchandise and service imports and 3.6 times private and public sector debt payments due over the next twelve months. The Philippines external debt remains manageable by international standards, with the combined outstanding obligations of the public and private sectors at 33% of GDP as of June 2009, compared to 34% of GDP as of mid-2008.

Capitl Available, Bond Market Thriving

¶9. (U) Commercial banking loans expanded 6%, which is a slower pace than the double-digit growth rates of the past several years. Central Bank and banking sector officials stressed there is no liquidity/credit crunch and that reduced growth in bank loans is consistent with the economy's more tempered expansion. They noted that a number of the country's major corporations also opted to take advantage of alternative sources of financing, particularly the bond market. Corporate bonds floated from January-August totaled nearly 200 billion pesos (roughly $48 billion), more than double the corporate bonds issued during the first eight months of 2008.

¶10. (U) The banking system's asset quality indicators remain stable at pre-global financial crisis rates of between 4%-5%. According to latest estimates, aerage non-performing loan and no-performing asset ratios stood at 4.2% and 4.9%, respectively, as of end-August
¶2009.

Stock Market Rebounds 57 Percent

¶11. (U) The Philippine Stock Exchange index -- which closed down 48% in 2008 from 2007 -- has been on an upward trajectory since April 2009, reacting positively to improvements in the Philippine and global economies. As of October 15, the index was up 57% from the start of the year.

Climate Change: Dark Clouds Hovering

¶12. (U) President Gloria Macapagal-Arroyo noted that flooding, destruction, and displacement caused by two consecutive typhoons (Ketsana and Parma) just weeks before the economic briefing -- as well as by 2008's Typhoon Frank from which the country had yet to fully recover -- required coordinated rehabilitation efforts. She announced the creation of a multi-sector National Reconstruction Commission, which she tasked with coordinating an international pledging session. Arroyo requested donor grants (over concessional loans and commercial borrowing) to avoid adding to the fiscal deficit and debt and debt-service ratios, noting that "the Philippines is a victim of climate change, not a culprit" and contributes "less than one percent to global warming."

¶13. (U) President Arroyo also signed the "Climate Change Act of 2009" into law (on October 23), authorizing the creation of a Climate Change Commission under the Presidency. The law's objective is to factor climate change into policy formulation, development planning, and poverty reduction programs. She thanked Congress for supporting a 12 billion peso (roughly $255 million) supplemental budget for 2009 and called for passage of a pending "Disaster Risk Reduction and Management" bill.

Fiscal Sector: A Brewing Crisis?

¶14. (SBU) Consecutive external shocks (the food, oil and global financial crises) forced the national government to postpone its

goal of balancing the budget from 2008 to 2013(Ref B). Senior officials from the Philippine Bureau of Treasury told econoffs they expect the fiscal deficit to exceed the 250 billion peso (3.2% of GDP) programmed ceiling for the year -- with the actual deficit hovering at about 300 billion pesos (3.5% of GDP) by year's end -- reflecting revenue collection shortfalls and added pressures from disaster relief and rehabilitation

¶15. (SBU) The tax-to-GDP ratio has stagnated at about 14% in recent years and is running at 13.5% thus far in 2009, because of recent revenue-eroding tax measures (tax relief for minimum wage and individual income earners and a five percentage point reduction to 30% of the corporate income tax rate), lower-than-expected tariff collections from a sharper-than-expected import slump, and persistent revenue collection problems. Economists warn that weak revenues and ballooning deficits caused by stimulus spending could limit future access to low-cost financing, constrain economic growth, and undermine macroeconomic stability in the medium to long term. Revenue-raising measures being pushed by the Department of Finance include excise tax reforms for liquor and tobacco and fiscal incentives rationalization. However, these face increasing resistance in the Philippine Congress this close to an election year.

Businesses, Donors Call for Longer-Term Growth Focus
--- -------

¶16. (U) During the annual Philippine Business Conference organized by the Philippine Chamber of Commerce and Industry, investors and international donors acknowledged the economy's ability to weather the impact of external shocks in the short-term but expressed concern over the economy's long-term prospects. They noted the country's efforts to improve the business/investment climate had

lagged that of its neighbors and called for aggressive efforts to improve Philippine competitiveness. The Philippines dropped from 71st place to 87th of 133 countries in the World Economic Forum's 2009-2010 Global Competitiveness Report; from 141st to 144th among 183 countries in the World Bank-International Finance Corporation's 2009 Doing Business Report; and from 40th to 43rd among 57 countries in the International Institute for Management Development's 2009 World Competitiveness Yearbook. The country's 15% investment-to-GDP ratio lags the 20%-40% ratios of most Southeast Asian neighbors.

Comment

¶17. (SBU) There is still broad agreement that the government's 0.8%-1.8% targeted growth rate for 2009 remains achievable despite the recent typhoons. Growth continues to be stimulated by overseas remittances, and disaster relief and rehabilitation spending will also help boost the economy. Concern has turned to longer-term growth and employment prospects for a country where a third of the population is subsisting below poverty thresholds. Economists estimate that the economy should achieve and sustain 7% to 8% annual growth to make significant inroads against poverty, given the Philippines' rapidly growing population. Expanding the economy with limited fiscal resources and climate change-related threats will be a major challenge for the new administration that assumes office in
¶2010.

Kenney